

COUNTY OF ORANGE
AUDIT OVERSIGHT COMMITTEE

MEETING MINUTES
Thursday, June 9, 2004, 2:00 p.m.

The Audit Oversight Committee of the County of Orange met on June 9, 2004 at 2:08 p.m., in the Hall of Administration, Building, 5th Floor, Conference Room B, Santa Ana, California.

Members Present/Absence Noted:

Present: Mr. James Ruth, CEO
Mr. David Sundstrom, Auditor-Controller
Dr. Dave Carlson, Public Member
Supervisor Jim Silva, Vice-Chair, Board of Supervisors
Supervisor Tom Wilson, Chair Board of Supervisors
Mr. John Moorlach, Treasurer-Tax Collector, Ex-Officio Member

1. Call to Order: (David Sundstrom, Vice -Chair, Audit Oversight Committee)

Mr. Sundstrom, Vice-Chair, called to order the meeting on June 9, 2004 at 2:07 p.m. Mr. Sundstrom asked for roll call before proceeding with the agenda.

Committee Members:

Mr. Ruth, Mr. Sundstrom, Dr. Carlson, Supervisor Silva, Supervisor Wilson, Mr. Moorlach attended only for Item 4, then left the meeting.

Guests:

Internal Audit Staff: Dr. Peter Hughes, Eli Littner, Michael Goodwin, Autumn McKinney, Alan Marcum, Renee Aragon, Scott Suzuki, Toni Smart, Camille Gackstetter; Auditor-Controller Staff: John Nakane, Claire Moynahan, Suzanne Luster; Macias, Gini and Company, Jean Horimoto, James Godsey; Second District Staff: Michelle Grettenberg

2. Approval of Minutes from December 3, 2003 (David Sundstrom, Vice-Chair, Audit Oversight Committee)

Recommended Action: Approve

Approved as recommended.

3. Macias, Gini and Company, Required Communications (James Godsey, Partner, Macias, Gini & Company)

Recommended Action: Discussion

Mr. Godsey addressed the Committee and provided status as part of their required communications to the County for the current year audit. During the planning stages of the audit, the external auditor was required to meet with the AOC and clarify the standards for the current year. Mr. Godsey referred to the package and clarified the issues of standards for the current year. He stated they would be auditing the CAFR and includes management discussion analysis, supplemental combined schedules and schedule of federal awards. In addition, John Wayne Airport, Integrated Waste Management Dept., Orange County Development Agency, and the Orange County Special Financing Authority stand-alone audits would also be performed. Under separate contract, they were selected to add the Orange County Children and Family Commission audit. He stated all the audits would be rolled into the Countywide financial statements. The audit objectives had not changed and were the same used in the past.

He noted that under management responsibilities a significant new audit standard, SAS 99, explained the audit responsibility for the detection of fraud. The change placed responsibility and emphasis on County Management. In anticipation of this new change, they had discussions with several County management representatives and addressed the AOC over the past couple of years in preparation for the resulting changes. He stated the County had done a good job in identifying and assessing risk and addressing the necessary controls. The standard clarified that the external auditor could not be held responsible for identifying certain types of fraudulent activities. Mr. Ruth said that same communication must be conveyed to Executive Management team and that reliance was not all on the auditors, but shared by Management. Mr. Godsey stated the Internal Audit function was aware of the responsibility as well as the Auditor-Controller. He stated this would be stressed as they meet with various managers in the County. Mr. Godsey stated they were using data extraction software for testing and analytical reviews and would be working with Internal Audit. The audit is designed to obtain reasonable not absolute assurance. He estimated date for completion as December 31, 2004.

(Supervisor Wilson joined the meeting at 2:15 p.m.)

4. Consideration of Outsourcing the Annual SB866 Audit to an Independent Certified Public Accounting (CPA) Firm (John Moorlach, Treasurer Tax-Collector, Ex-Officio AOC Member)
Recommended Action: Discussion

Mr. Moorlach stated that two members of the AOC, the CEO and the Auditor-Controller, also serve as members on the Treasury Oversight Committee (TOC). Two years ago he had an understanding that the Board and CEO would prefer for Internal Audit to perform this annual audit at no cost. At the time, Mr. Moorlach sought an outside CPA firm to perform the mandatory audit. This year, the CEO wants to charge the Treasurer Tax-Collector for the cost of the audit. As a cost saving measure, Mr. Moorlach would like to seek an outside CPA firm to perform the audit. He stated he believed the current cost was \$100 per hour at approximately 800 hrs. Before soliciting a firm, Mr. Moorlach was seeking approval of the AOC. Supervisor Silva asked Mr. Moorlach to clarify if he was asking for an RFP. Mr. Moorlach said yes and asked for the County's Internal Audit Department (IAD) to be responsive to the same RFP.

Mr. Sundstrom stated he was statutorily required as the Auditor-Controller to perform certain quarterly reviews of the County's cash. Mr. Sundstrom stated he used IAD to perform those review. He explained the SB866 audit was an agreed-upon procedures review of the requirements contained within SB866. Mr. Sundstrom stated he thought IAD was doing more than required as an audit rather than the minimum requirement in statute. Irrespective of the AOC's choice on the SB866 audit, Mr. Sundstrom stated he would continue to use IAD to perform the quarterly reviews. Supervisor Silva asked who would do the RFP process. Mr. Sundstrom stated the RFP process would be conducted by the TOC and the administration of the RFP by the Treasurer's office. Mr. Sundstrom stated the TOC by statute remained responsible to ensure the SB866 audit. Supervisor Wilson asked about the time and cost for the RFP. Mr. Moorlach stated it wouldn't be difficult. He added that in addition to the SB866 audit, quarterly compliance audits formerly done by Fitch were also added because of changes from Enron. Therefore, he had IAD do the quarterly compliance audits as well as the annual compliance. Mr. Moorlach stated he was happy with IAD, but was seeking to save money.

Mr. Ruth stated the costs would be minimal to go out to bid and felt the departments should have the prerogative if they believe they can beat the cost to seek the private sector to compete and force internal staff to bid against it to make sure they are getting value for our money. Supervisor Wilson asked for Dr. Hughes' comments. Dr. Hughes stated IAD had performed the audit for the past 5 years and had done a thorough job. IAD used approximately 800 hours to do the audit. He stated only CPAs were staffed to perform the audit. The audit program was 11 pages and included 90 steps. The TOC had not seen the audit program to his knowledge. Dr. Hughes stated it would be good for the

TOC to determine which step and assigned hours should be eliminated. He added that vendors or IAD could bid blindly on the audit, but the steps used were tried and proven over 5 years. He also noted that junior staff were not used on the audit and would be surprised if another firm could do it cheaper than IAD because all CPA staff was used for the entire assignment. Mr. Alan Marcum stated that government code requires an annual audit. He explained an audit as rendering an opinion on compliance. He added that the code does not say to perform agreed upon procedures but rather an audit. There was a huge distinction between agreed upon procedures versus an audit rendered opinion and one cost a great deal more than the other. With an agreed upon procedure the TOC and County would be responsible for the procedures and with an audit rendered opinion the CPA firm would take full responsibility for the procedures. Supervisor Silva requested a fair comparison. Mr. Sundstrom asked Mr. Moorlach if the bid that went out last time was for agreed upon procedures or an audit. Mr. Moorlach did not have a copy of the last RFP. Mr. Sundstrom stated they should be careful to use the correct comparison as well as experienced staff for use on the audit. Dr. Hughes noted the painful ramifications of KPMG former external auditor of the County hired as a low bidder. He stated KPMG under bid the then current auditor by 50%. They then narrowed their review and the end result was an estimated 1500 hours was reduced to 600 hours by KPMG. It was later revealed they short sheeted the investment portfolio review as part of their external audit. Dr. Hughes stated he would like to see the audit done right rather than cheap. Mr. Moorlach stated he didn't believe the TOC would lower the quality of the services rendered. Dr. Hughes stated he would give the audit steps used to the Mr. Moorlach for true comparisons. Mr. Ruth asked if the same audit that Internal Audit performed would be used in the bid and incorporated in the RFP. Mr. Moorlach stated he would use the same audit program that Internal Audit uses in their audit. Mr. Sundstrom stated the audit program should be used a minimum requirement.

Directive: The AOC directed Staff to proceed with an RFP process to include as a minimum requirement the established IAD audit program and steps used in the SB866 audit.

Mr. Moorlach left the meeting at 2:30 p.m.

5. Best Practices and Benchmarking (Dr. Peter Hughes, Director, Internal Audit)
Recommended Action: Presentation

Dr. Hughes stated that best practices and benchmarking information was used in preparation for the peer review performed by Jefferson Wells. The information added value to the peer review in that IAD stayed close to ongoing developments and changes in the audit profession. Dr. Hughes stated the data demonstrated the Supervisors' vision to build a highly professional audit department in the products produced and the level of seasoned staff. The compiled data was impressive and Orange County lead in most cases by comparison to ten other counties and/or cities in the state. It was noted that Orange County was and remained the only County in California with the reporting structure to the Board of Supervisors and that had an Audit Oversight Committee and also the only audit department to develop Business Plans and Strategic Plans on an annual cyclical basis.

Dr. Dave Carlson, Public Member, arrived at 2:45 p.m.

6. External Peer Review of Internal Audit Department (Dr. Peter Hughes, Director, Internal Audit)

Recommended Action: Receive and File.

ITEM 6 was heard after Item 7.

Dr. Hughes stated the Jefferson Wells report was a standard classic peer review. He stated it was a check list audit. They validate compliance with approximately 100 different standards. Also, they evaluated the reporting relationships, the qualifications of staff and review work papers for evidence of proper supervision. Also, they looked for support on audit conclusions. Dr. Hughes stated Mr. Sundstrom directed him that the review be completed in order to satisfy the Yellow Book requirement. Dr. Hughes stated it fit nicely with item 7. It was completed and Jefferson Wells' conclusion was that IAD fully complied with the professional standards as did the previous review three years prior.

The item was approved as recommended.

7. Peer Review Subcommittee Recommendation of Vendor Selection to Perform a Quality Assessment of Internal Audit Department (David Sundstrom, Vice-Chair, AOC Committee)

Recommended Action: Select Vendor and authorize Auditor-Controller to seek final approval from the Board of Supervisors

ITEM 7 was heard before Item 6.

Mr. Sundstrom stated the AOC bylaws state the AOC was required to ensure Internal Audit have a peer review on a 3 year cycle review. The subcommittee was formed to select a firm. Mr. Sundstrom discussed the vendor selection, ratings and evaluations. Mr. Sundstrom stated TCBA was the successful bidder. The item did not need Board approval because the price came in under \$50,000.

Mr. Carlson arrived at 2:45 p.m.

Mr. Marcum stated item 6 that was heard out of order and met the requirements for a peer review under the standards. Mr. Carlson asked what was additionally required given that the peer review was done. Mr. Sundstrom stated the bid selection on the quality assessment peer review was to focus on the risk coverage and he wanted to seek competitive bidders. Mr. Goodwin asked if the vendor would do a countywide risk assessment. Mr. Sundstrom stated the vendor would evaluate IAD's risk assessment practices. Mr. Carlson stated it was his understanding that the vendor would perform a classic peer review and item 6 should be taken into account. Mr. Sundstrom stated item 6 would be taken into account and provide for reduced cost for the selected vendor. Mr. Marcum stated that at the last AOC questions about independence of Jefferson Wells was raised. The GAO was contacted and clarified that Jefferson Wells was independent to complete the review. Mr. Sundstrom stated it was the opinion of the AOC and not the GAO to be in accordance with the AOC bylaws. He wanted the vendor to be totally independent of all contractual relationships with IAD. He stated the AOC did not base their decision on the GAO standard and what they would or would not accept, but rather the AOC bylaws. Dr. Hughes stated he had been working with Mr. Sundstrom on the logistics on the peer review from Jefferson Wells. Dr. Hughes stated Mr. Sundstrom was seeking the benefits of an additional more comprehensive review of the risk process itself. Dr. Hughes stated he had informed Mr. Sundstrom of the looming deadline to have the peer review completed by June 1 in order to be compliant with the GAO Yellow Book or IAD would have had to qualify their opinions on all their government audits. Given that the GAO satisfied the independence of Jefferson Wells, Dr. Hughes stated Mr. Sundstrom had directed that the peer review component be completed to remain in compliance. That report in return could possibly be used for this review for the vendor to build upon and focus on the risk and possibly reduce cost.

Approved as recommended.

8. Internal Audit's Responses to Grand Jury Report on the County Hotline (Dr. Peter Hughes, Director, Internal Audit Department)

Recommended Action: Discussion

Dr. Hughes stated the Grand Jury hotline report did not find fault with process itself. They did not fault how investigations were handled or the integrity of the process which was the heart of the matter. The observations were cosmetic in general. They wanted Internal Audit to promote the hotline to employees and provide better after hours coverage. There was on-going coordination with several departments to enhance the process. Dr. Carlson stated it was a bit troublesome that callers weren't prompted to leave more detail under the old telephone system and he welcomed the recommendations of the Grand Jury.

Approved as recommended.

9. Status Report #2 – Period 02-06-04 to 05-20-04 (Dr. Peter Hughes, Director, Internal Audit Department)

Recommended Action: Receive and File

The status report tracks the progress of the audit plan coverage. IAD was on budget and on schedule.

Approved as recommended.

10. External Audit Activity Third Quarter FY 03/04 Status Report (Dr. Peter Hughes, Director, Internal Audit Department)

Recommended Action: Receive and File

External audit coverage had been helpful and provided a useful tool to determine the outside activity from the State or Federal levels. Mr. McKinney stated it was a comprehensive report and IAD added some subcategories to identify sections in the larger departments. She stated there was 100% participation. There was consideration given to the coverage when planning the annual audit plan coverage.

Approved as recommended.

11. Executive Summaries of Audit Assignments, Period 2/27/04 to 06/09/04 (Dr. Peter Hughes, Director, Internal Audit Department)

Recommended Action: Receive and File

Dr. Hughes stated the Executive Summaries identified trends or issues from one AOC meeting to the next. Follow up reviews were also detailed from one meeting to the next. Mr. Ruth stated the departments in 2002 had a 66% response to audit recommendations rating and the following year it was improved to 85% and complimented their efforts for implementing the recommendations timely.

Approved as recommended.

12. Next Meeting

- ◆ This meeting will be scheduled according to the completion of the peer review/quality assessment of Internal Audit Department. The meeting was scheduled for October 6, 2004.

13. Public Comments

none.

14. Adjournment

The meeting was adjourned at 3:30 p.m.

Approved 10-6-04, Item 2.